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Nos. 95-966 and 95-977

In the Supreme Court of the United States

OCTOBER TERM, 1995

KEVIN M. O'GILVIE AND STEPHANIE L. O'GILVIE,
MINORS, PETITIONERS

v.

UNITED STATES OF AMERICA

KELLY M. O'GILVIE, PETITIONER

v.

UNITED STATES OF AMERICA

*ON WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT*

BRIEF FOR THE UNITED STATES

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QUESTIONS PRESENTED

1. Whether a punitive damage award in a wrongful death action is excluded from gross income under Section 104(a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injuries or sickness" (26 U.S.C. 104(a)(2)).

2. a. Whether the appeal by the United States from the judgment entered by the district court in the case brought by Kelly O'Gilvie (No. 95-977) was timely.

b. Whether the action filed by the United States for the recovery of an erroneous refund made to Kevin and Stephanie O'Gilvie (No. 95-966) was commenced within the time permitted by 26 U.S.C. 6532(b).

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-22a) is reported at 66 F.3d 1550.[1] The opinion of the district court (Pet. App. 25a-27a) is reported at 71 A.F.T.R.2d 547.

JURISDICTION

The judgment of the court of appeals was entered on September 19, 1995. The petitions for writs of certiorari were filed on December 18, 1995, and were grant-

[1] "Pet. App." refers to the appendix to the petition in No. 95-966.

ed on March 25, 1996. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATEMENT

1. Petitioners Kevin and Stephanie O'Gilvie are the children of petitioner Kelly O'Gilvie and of Betty O'Gilvie, who died in 1983 of toxic shock syndrome. On behalf of his wife's estate and his children, Mr. O'Gilvie brought a civil action against the manufacturer of the product that caused her death. The jury awarded petitioners actual damages of $1,525,000 and punitive damages of $10,000,000. The trial court remitted the punitive damage award to $1,350,000, but the full award was reinstated on appeal (Pet. App. 3a).

The judgment for punitive damages was paid and distributed to petitioners in 1988. Net of attorneys fees and expenses, Kevin and Stephanie O'Gilvie each received punitive damages in the amount of $1,241,823 and Mr. O'Gilvie received punitive damages in the amount of $2,483,646. Petitioners reported those amounts as income on their 1988 federal tax returns and paid the taxes due (Pet. App. 3a).

2. In 1989, Mr. O'Gilvie filed a claim for refund of the taxes he paid on the punitive damage award. He asserted that the award of punitive damages is excluded from gross income under Section 104(a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injuries or sickness" (26 U.S.C. 104(a)(2)). When the refund claim was not granted, Mr. O'Gilvie commenced this refund suit against the United States in federal district court (Pet. App. 3a-4a).

Refund claims were also filed for Kevin and Stephanie O'Gilvie in 1989. They also asserted that the punitive damage award was not subject to tax

under Section 104(a)(2). The Internal Revenue Service approved and paid those refund requests on July 9, 1990 (Pet. App. 8a, 38a). On July 9, 1992, however, the United States commenced an action under 26 U.S.C. 7405(a) to recover these payments as erroneous refunds (Pet. App. 8a). That suit was filed in the same court in which Mr. O'Gilvie's action was pending. The parties stipulated in the children's case that "[t]here are no factual issues in dispute in this litigation" and that "[t]he sole legal issue in dispute between the parties is whether the punitive damages received by the defendants are excludable from income pursuant to 26 U.S.C. Section 104(a)(2)" (Pet. App. 39a). The parties in that case "therefore agree[d] to be bound by the final judgment of the district court" in Mr. O'Gilvie's case, subject only to the understanding that they would be permitted to appeal any adverse judgment "on the merits" and, on such an appeal, would also be permitted to contend that "they were not properly served with the summons and complaint * * * in accordance with Kansas law" (*ibid.*).

3. a. On May 26, 1992, the district court entered an order in Mr. O'Gilvie's refund suit holding that punitive damages do not represent compensation for an injury and are therefore not excluded from gross income by Section 104(a)(2). On a motion for reconsideration, however, the district court vacated its prior order, holding instead that punitive damages are excludable from gross income under Section 104(a)(2). An order entering judgment in favor of Mr. O'Gilvie on that claim was issued on August 26, 1992 (Pet. App. 5a).

An additional issue remained for adjudication in Mr. O'Gilvie's case. He contended that the post-trial in-

terest that he received on the portion of the judgment for punitive damages that had been remitted and then reinstated should be excluded from gross income under Section 104(a)(2). Because that claim had not been adjudicated, the district court entered an order on October 27, 1992, that withdrew the August 26 order "subject to reinstatement at the conclusion of the case" (Pet. App. 6a n.5). The district court thereafter entered an order on November 30, 1993, holding that such interest is taxable income and entering judgment in favor of the government on that issue at that time (*id.* at 5a-6a).

One week later, on December 7, 1993, the district court entered an "amended" and final judgment in Mr. O'Gilvie's case. That order (i) granted judgment in favor of Mr. O'Gilvie on his claim that the punitive damages award that he received was not subject to tax and (ii) granted judgment in favor of the government on Mr. O'Gilvie's claim that the interest he received was not subject to tax (Pet. App. 6a). On January 5, 1994, Mr. O'Gilvie filed a notice of appeal from the part of the judgment unfavorable to him. On February 1, 1994, the government filed its notice of appeal in Mr. O'Gilvie's case (*id.* at 7a).

b. Pursuant to the stipulation that had been entered in the companion case, the district court entered an order on February 22, 1994, dismissing the government's claim for recovery of the refund paid to Kevin and Stephanie O'Gilvie (J.A. 66a). The government filed a notice of appeal in that case, and the two cases were consolidated in the court of appeals (Pet. App. 2a, 7a).

4. a. On appeal, Mr. O'Gilvie asserted that the government's notice of appeal in his case was not timely because, even though it was filed within 60

days of the December 7, 1993, "amended" and final judgment, it was not filed within 60 days of the November 30, 1993, judgment that disposed of the interest issue only.

The court rejected petitioner's claim (Pet. App. 7a-8a). Noting that the August 26, 1992, judgment on the punitive damages issue had been vacated, and the November 30 judgment addressed only the interest issue, the court of appeals held that the December 7 judgment was the only judgment that disposed of both the interest and punitive damages issues and was therefore the only final judgment from which an appeal could be filed. The notice of appeal was filed by the government within 60 days of that judgment and was therefore timely (*id.* at 7a-8a).

b. On appeal, Kevin and Stephanie O'Gilvie sought to defend the judgment in their favor by raising a contention that they had waived in the district court. Under 26 U.S.C. 6532(b), "[r]ecovery of an erroneous refund by suit under section 7405 shall be allowed only if such suit is begun within 2 years after the making of such refund." The government's complaint was filed on July 9, 1992, and alleged that the Internal Revenue Service refunded the taxes at issue on July 9, 1990. Kevin and Stephanie O'Gilvie admitted those facts in their answer and in their stipulation and did not raise any defense based upon the statute of limitations (J.A. 64a; Pet. App. 38a).[2] In the court of appeals, however, they asserted that, although they received

[2] They also stipulated in the district court that they would be bound by the judgment below and could raise on appeal only questions relating to "the merits" of the tax issue and a question as to whether personal service had been made on them "in accordance with Kansas law" (Pet. App. 39a).

the refund checks in the mail on July 9, 1990, the checks had been mailed earlier; they argued that a refund is made for purposes of Section 6532(b) when the check is mailed, rather than when it is received. Asserting that the "checks had to have been mailed before July 9, 1990" (Pet. App. 8a), they contended in the court of appeals that the government's suit was filed more than two years after the refund was made and was therefore untimely (*ibid.*).

The United States pointed out that the defense that Kevin and Stephanie O'Gilvie now sought to raise in the court of appeals had not been pled or raised in any fashion in the court below (U.S. Reply and Answering Br. at 1, 2). The court of appeals nonetheless addressed petitioners' new contention on the merits. Assuming that the new factual assertions proffered by petitioners were correct, the court of appeals held that the new legal contention that they raised was nonetheless invalid (Pet. App. 10a). The court noted that it has long been held that a tax refund is made "when the check in payment of the obligation is delivered" (*Paulson* v. *United States*, 78 F.2d 97, 99 (10th Cir. 1935)). The court observed (Pet. App. 9a) that this Court reached a similar conclusion in *United States* v. *Wurts*, 303 U.S. 414 (1938), which held that the issuance of a refund check does not itself constitute a "refund" because payment could be stopped and the check cancelled "even after a check was signed and mailed." *Id.* at 417-418. Because a "refund" is not made until the funds are received by the taxpayer, the court held that the government's suit was timely in this case (Pet. App. 10a).

c. On the merits of the substantive tax issue, the court of appeals reversed the district court. The court of appeals noted that four other circuits have

held that punitive damage awards in personal injury cases are not excludable from income under Section 104(a)(2) (Pet. App. 13a, citing *Wesson* v. *United States*, 48 F.3d 894 (5th Cir. 1995); *Hawkins* v. *United States*, 30 F.3d 1077 (9th Cir. 1994), cert. denied, 115 S.Ct. 2576 (1995); *Reese* v. *United States*, 24 F.3d 228 (Fed. Cir. 1994); *Commissioner* v. *Miller*, 914 F.2d 586 (4th Cir. 1990)). The court agreed with those circuits that the text of Section 104(a)(2)—which provides an exclusion from income only for damages received "on account of" personal injuries—is subject to more than one interpretation. It could be read to encompass any monetary award received in a personal injury suit; or, it could be read to refer only to damages awarded "on account of" the injury and not to damages awarded "on account of" the egregious or malicious nature of the conduct of the defendant (Pet. App. 17a). Concluding that the text and history of the statute do not resolve whether Congress intended to exclude punitive damages from income under Section 104(a)(2), the court applied the well-established rule that exclusions from income must be narrowly construed and held that punitive damages are therefore not excludable from income under Section 104(a)(2) (Pet. App. 22a, citing *United States* v. *Burke*, 504 U.S. 229, 248 (1992) (Souter, J., concurring)).

The court noted (Pet. App. 14a-16a) that the only circuit that has reached a different conclusion (*Horton* v. *Commissioner*, 33 F.3d 625, 630 (6th Cir. 1994)) erroneously relied on a rationale that this Court expressly rejected in *Commissioner* v. *Schleier*, 115 S. Ct. 2159 (1995). In *Horton*, the Sixth Circuit reasoned that, if "the underlying claim is one for a personal, physical injury," the "entire recovery is excludable" under Section 104(a)(2). 33 F.3d at 631. In

Commissioner v. *Schleier*, however, this Court stated that (Pet. App. 16a, quoting 115 S. Ct. at 2167):

> the plain language of § 104(a)(2), the text of the applicable regulation, and our decision in *Burke* establish two independent requirements that a taxpayer must meet before a recovery may be excluded under § 104(a)(2). First, the taxpayer must demonstrate that the underlying cause of action giving rise to the recovery is "based upon tort or tort type rights"; and second, the taxpayer must show that the damages were received "on account of personal injuries or sickness."

The court of appeals in *Horton* failed to address the statutory requirement that the damages to be excluded from income were received "on account of personal injuries" and "misconstrued *Burke* as holding that § 104(a)(2) required only that there be a tort-type injury" (Pet. App. 16a).

SUMMARY OF ARGUMENT

1. A punitive damage award in a wrongful death case is not excluded from gross income under Section 104(a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injuries or sickness." 26 U.S.C. 104(a)(2). In *Commissioner* v. *Schleier*, 115 S. Ct. 2159, 2167 (1995), the Court held that a taxpayer must establish "two independent requirements" to qualify for the exclusion provided in Section 104(a)(2). First, the taxpayer must establish that the underlying cause of action giving rise to the recovery is based upon tort or tort type rights. That requirement is unquestionably met in a wrongful death case. Second, the taxpayer must establish that the damages were received "on account of" a personal

injury. That requirement is not met by a punitive damage award.

As this Court reasoned in *Commissioner* v. *Schleier*, *supra*, damages that are "punitive in nature," rather than compensatory, do not meet the statutory requirement that the damages be received "on account of" personal injuries or sickness. Damages that are "punitive in nature" are designed to punish the wrongdoer, not to compensate the plaintiff. Punitive awards are not awarded "on account of" the personal injury; they are awarded on account of the tortfeasor's malice. Because punitive damages are awarded to punish and deter the tortfeasor, rather than as compensation for the plaintiff's injury, they are not excluded from income by Section 104(a)(2).

As five of the courts of appeals have concluded, that understanding of the statute comports with its text, its structure, its history and its evident purpose. It is also compelled by the established principle that exclusions from income must be narrowly construed.

2. a. The notice of appeal that the government filed in the case of petitioner Kelly O'Gilvie (No. 95-977) was not untimely. The refund suit commenced by Kelly O'Gilvie presented two distinct issues: (i) whether a punitive damage award is excluded from gross income under Section 104(a)(2) of the Internal Revenue Code; and (ii) whether post-trial interest paid on such damages is excluded from gross income under that statute. On August 26, 1992, the court entered judgment in favor of petitioner with respect to the first issue. But that judgment was withdrawn on October 27, 1992, because the second issue had not yet been decided. On November 30, 1993, the court adjudicated and entered judgment in favor of the government on the second issue. On December 7,

1993, the court then entered an "amended" judgment that, for the first time, addressed both issues. The December 7, 1993, judgment was the only judgment that disposed of the entire case and was thus the only judgment from which an appeal could be taken. The notice of appeal was filed by the government within 60 days from that date and was therefore timely.

b. The suit brought by the government for recovery of the refund erroneously made to Kevin and Stephanie O'Gilvie (No. 95-966) is not barred by the applicable statute of limitations. The affirmative defense of the statute of limitations was not raised in their pleadings, is precluded by their stipulation, was not presented to the district court and therefore may not be raised at this time.

In any event, under Section 6532(b) of the Internal Revenue Code, an erroneous refund may be recovered in a suit brought within two years "after the making of such refund." 26 U.S.C. 6532(b). It is well established that a "refund" is not made until the funds are delivered to the taxpayer. As this Court stated in *United States* v. *Wurts*, 303 U.S. 414, 417-418 (1938), a refund is not made "even after a check is signed and mailed," for the check may be cancelled and not paid. A "refund" is made when the money is restored to the taxpayer—when the "funds" are delivered to him. Because the government filed its suit for recovery of the erroneous refund in this case within two years of the date on which the refund checks were received by petitioners, the suit was timely under Section 6532(b).

ARGUMENT

I

A PUNITIVE DAMAGE AWARD IS NOT EXCLUDED FROM GROSS INCOME UNDER SECTION 104(a)(2) OF THE INTERNAL REVENUE CODE AS "DAMAGES RECEIVED * * * ON ACCOUNT OF PERSONAL INJURIES OR SICKNESS"

The first step in calculating taxable income under the Internal Revenue Code is to determine the taxpayer's "gross income." Section 61(a) provides that, subject to specific exclusions set forth elsewhere in the Code, "gross income means all income from whatever source derived." This sweeping statutory definition broadly reflects the Legislature's intent to exert the full measure of its taxing power. *Commissioner* v. *Schleier*, 115 S. Ct. at 2163; *United States* v. *Burke*, 504 U.S. 229, 233 (1992). Any funds or other "accessions to wealth" (*Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955)) received by a taxpayer represent "gross income" unless the taxpayer establishes that the income falls within one of the specific exclusions created by other Sections of the Code.

It is not disputed that the punitive damages received by petitioners represent an "accession to wealth" that constitutes "gross income" within the broad scope of Section 61(a). The question presented in this case is whether that payment is excluded from "gross income" by Section 104(a)(2) of the Code, which provides that "gross income does not include * * * the amount of any damages received * * * on account of personal injuries or sickness." 26 U.S.C. 104(a)(2). As an exclusion from gross income, Section

104(a)(2) must be narrowly construed. *Commissioner* v. *Schleier*, 115 S. Ct. at 2163; *United States* v. *Centennial Savings Bank*, 499 U.S. 573, 583-584 (1991). See also *United States* v. *Burke*, 504 U.S. at 244 (Scalia, J., concurring); *id.* at 248 (Souter, J., concurring).

A. *Section 104(a)(2) authorizes an exclusion from income only for damages received on account of personal injuries or sickness*

In *Commissioner* v. *Schleier*, 115 S. Ct. at 2167, the Court explained that a taxpayer must establish "two independent requirements" to qualify for the exclusion provided in Section 104(a)(2). First, the taxpayer must establish that the underlying cause of action giving rise to the recovery is based upon tort or tort type rights. 115 S. Ct. at 2167. See also *United States* v. *Burke*, 504 U.S. at 237; Treas. Reg. § 1.104-1(c) (the term "damages received" means "an amount received * * * through prosecution of a legal suit or action based upon tort or tort type rights"). The "primary characteristic" of a tort type action is the availability of compensation for "the traditional harms associated with personal injury, such as pain and suffering, emotional stress, harm to reputation, or other consequential damages." *Commissioner* v. *Schleier*, 115 S.Ct. at 2167, quoting *United States* v. *Burke*, 504 U.S. at 239. That requirement is unquestionably met in a wrongful death action, such as is involved in this case.

The Court emphasized in *Commissioner* v. *Schleier*, however, that the fact that the damages were awarded in a "tort or tort type" suit does not "constitute[] the beginning and end of the analysis." 115 S. Ct. at 2167. That the damages were recovered in a

tort-like cause of action is only "a necessary condition for excludability under § 104(a)(2), it is not a sufficient condition." *Ibid.* The second, independent requirement of the statute is that the taxpayer must establish that the damages received were "on account of" a personal injury. *Id.* at 2166, 2167. To satisfy this second requirement, the taxpayer must show that the damages recovered were "attributable to" the personal injury and that the "personal injury affected the amount of [the recovery.]" *Id.* at 2164.

The decision in *Schleier* provides an example of the operation of this second requirement of the statute. In *Schleier*, the Court acknowledged that a violation of the Age Discrimination in Employment Act may cause "psychological or 'personal injury'" to the employee. 115 S. Ct. at 2164. But the statutory award of back pay redresses only the loss of wages that results from a violation of the Act; the award "is completely independent of the existence or extent of any personal injury." 115 S. Ct. at 2164. The Court concluded that the recovery of back wages under the Act "was not 'on account of' any personal injury * * * because no personal injury affected the amount of back wages recovered." *Ibid.* A recovery in a personal injury suit that is not "attributable to that injury" is not excluded from income under Section 104(a)(2). 115 S. Ct. at 2164.

B. *Punitive damages are not received "on account of" personal injuries*

1. In *Schleier*, the Court rejected the contention that the statutory award of liquidated damages for willful violations of the Age Discrimination in Employment Act is excluded from tax under Section 104(a)(2). The Court explained that such damages are

"punitive in nature," rather than compensatory, and therefore do not meet the statutory requirement that the damages be received "on account of" personal injuries or sickness. 115 S. Ct. at 2165.

Damages that are "punitive in nature" are designed to punish the wrongdoer, not to "compensate plaintiffs for personal injuries." *Commissioner* v. *Schleier*, 115 S. Ct. at 2165. As this Court stated in *International Brotherhood of Electric Workers* v. *Foust*, 442 U.S. 42, 48 (1979), quoting *Gertz* v. *Robert Welch, Inc.*, 418 U.S. 323, 350 (1974):

> Punitive damages "are not compensation for injury. Instead, they are private fines levied by civil juries to punish reprehensible conduct and to deter its future occurrence."

See also *BMW of North America, Inc.* v. *Gore*, No. 94-896 (May 20, 1996), slip op. 7 (punitive damages are awarded to "punish[] unlawful conduct and deter[] its repetition"). Damages awarded as punishment of a wrongdoer, rather than as compensation for injury, are awarded "on account of" the malice or willfullness of the tortfeasor, not "on account of" personal injury. *Commissioner* v. *Miller*, 914 F.2d at 589-592. Accord, *Hawkins* v. *United States*, 30 F.3d at 1080-1084; *Reese* v. *United States*, 24 F.3d at 230-235. Moreover, the amount of the punitive award is measured by the State's interest in punishing and deterring the wrongdoer's conduct; it is not measured by the personal injury of the plaintiff. *BMW of North America, Inc.* v. *Gore*, slip op. 7 (punitive damages are awarded in amounts "reasonably necessary to vindicate the State's legitimate interests in punishment and deterrence"). As five of the courts of appeals have held (Pet. App. 13a), punitive awards therefore do not

represent damages "on account of personal injury" within the meaning of Section 104(a)(2).[3]

"[T]he common law recognizes that damages intended to compensate the plaintiff are different in

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[3] The only circuit that reached a different conclusion relied on an understanding of Section 104(a)(2) that this Court expressly rejected in *Commissioner* v. *Schleier*, *supra*. In *Horton* v. *United States*, 33 F.3d at 631, the Sixth Circuit stated that, if "the underlying claim is one for a personal, physical injury," the "entire recovery is excludable" under Section 104(a)(2). In *Schleier*, however, the Court stated that the question whether "the underlying action is 'based upon tort or tort type rights'" is *not* "the beginning and end of the analysis." 115 S. Ct. at 2167 (quoting *Burke*, 504 U.S. at 234). There are "two independent requirements that a taxpayer must meet before a recovery may be excluded under § 104(a)(2)." 115 S. Ct. at 2167. The taxpayer must demonstrate not only that the underlying cause of action is based upon tort or tort type rights; the taxpayer must also demonstrate "that the damages were received 'on account of personal injuries or sickness.'" *Ibid.* As all other courts of appeals have recognized (Pet. App. 13a-16a), it is the latter requirement, not the former, that controls the determination whether punitive damages are excluded from income under Section 104(a)(2). The decision in *Horton* does not address the latter requirement and thus plainly fails to apply the analysis required by this Court in *Schleier*.

The Ninth Circuit once held that punitive damages were excluded from income under the statute, but did so in reliance on a 1975 Revenue Ruling that had abandoned the Treasury's prior, longstanding position that punitive damages were not excluded from income under Section 104(a)(2). See *Commissioner* v. *Miller*, 914 F.2d at 591, citing *Roemer* v. *Commissioner*, 716 F.2d 693, 700 (9th Cir. 1983). After the Treasury returned to its original view, and ruled again in 1984 that punitive damages are not excluded from income (see pages 25-26, *infra*), the Ninth Circuit rejected its decision in *Roemer* and interpreted the statute not to exclude punitive damages from income. *Hawkins* v. *United States*, 30 F.3d at 1082.

kind from 'punitive damages'." *Molzof* v. *United States*, 502 U.S. 301, 307 (1992). "The term 'punitive damages' * * * embodies an element of the defendant's conduct that must be proved before such damages are awarded" (*id.* at 308). Petitioners have acknowledged that the punitive awards at issue in this case were designed to punish the tortfeasor and had no compensatory purpose (Pet. App. 14a n.10).[4] Because the award of punitive damages is attributable to the tortfeasor's malice, and is not compensation for the plaintiff's injury, the award is not excluded from income as "damages received * * * on account of personal injury or sickness" under Section 104(a)(2).

2. This understanding of the statute comports with its text, structure, history and evident purpose. It is also compelled by the established principle that exclusions from income must be narrowly construed.

a. As the court of appeals explained in *Reese* v. *United States*, 24 F.3d at 230, "[t]he language 'on account of' is not free of ambiguity; rather it is susceptible of at least two conflicting interpretations."

> Under a but-for causation approach, the fact that a plaintiff has to sustain a personal injury as a prerequisite to an award of punitive damages leads to the conclusion that the punitive damages were "on account of" the plaintiff's injury, even though a punitive damage award requires the additional showing of, and is responsive only to, egregious conduct by the defendant. However, under a sufficient causation approach, the fact that personal injury is a prerequisite to punitive damages does *not* lead to the conclusion that the punitive damages were "on account of" the plaintiff's injuries because, even if the other elements of the tort are present, personal injury alone does not sustain a punitive damage award. The fact that a plaintiff seeking punitive damages has to show egregious conduct by the defendant indicates that the plaintiff's injury was not a sufficient cause of the punitive damages. Thus, the mere fact that "on account of" suggests "causation" does not answer the question of whether "on account of" suggests but-for causation or sufficient causation.

[4] Petitioner Kelly O'Gilvie also acknowledges in his brief (95-977 Pet. Br. 16, 39) that the Court applied a "compensatory purpose" test in analyzing the scope of Section 104(a)(2) in *Commissioner* v. *Schleier*, *supra*.

Commissioner v. *Miller*, 914 F.2d at 589-590 (footnote omitted). Accord, *Reese* v. *United States*, 24 F.3d at 230-231.

Based upon the "well-recognized, even venerable, principle that exclusions to income are to be construed narrowly," these courts correctly resolved the conceptual ambiguity of the text in favor of a narrow construction of the statutory exclusion from income. *Commissioner* v. *Miller*, 914 F.2d at 590, citing *Commissioner* v. *Jacobson*, 336 U.S. 28, 49 (1949). See also *Hawkins* v. *United States*, 30 F.3d at 1084, citing *United States* v. *Centennial Savings Bank*, 499 U.S. at 583-584. They concluded that punitive damage awards are not excluded from income under Section 104(a)(2) because such awards are obtained "on account of" the defendant's malice or willfulness rather than "on account of" the personal injuries of the taxpayer.

b. The legislative history and evident purpose of the statute compel the same conclusion. Section 104(a)(2) was first enacted as Section 213(b)(6) of the Revenue Act of 1918, ch. 18, 40 Stat. 1066 (1919). As the court of appeals explained in *Reese* v. *United States*, 24 F.3d at 233 (parallel citations omitted), just prior to the enactment of the Revenue Act of 1918

> the Secretary of the Treasury requested an opinion from the Attorney General concerning the tax treatment of accident insurance proceeds received on account of personal injuries. *See* 31 Op. Atty. Gen. 304 (1918). In response, the Attorney General concluded that "the proceeds of an accident insurance policy [were] not 'gains or profits and income'" but were instead a return of capital and hence were not taxable in accordance with statute and precedent. *Id.* at 308; *accord Doyle* v. *Mitchell Bros Co.*, 247 U.S. 179, 185 (1918).
>
> After the Attorney General's report, the IRS issued a decision holding that "the proceeds of an accident insurance policy received by an individual on account of personal injuries . . . [were] not taxable . . . ." T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918). Moreover, the IRS held "upon similar principles that an amount received by an individual as the result of a suit or compromise for personal injuries" would not be taxable. *Id.*
>
> Subsequent to these events, Section 213(b)(6) was enacted. In a 1918 report of the House Committee on Ways and Means, Congress explained the rationale behind Section 213(b)(6) as follows:

> > Under the present law it is doubtful whether amounts received through accident or health insurance, or under workmen's compensation acts, as compensation for personal injury or sickness, and damages received on account of such injuries or sickness, are required to be included in gross income. The proposed bill provides that such amounts shall not be included in gross income.
>
> H.R. Rep. No. 767 at 9-10 (1918). With the passage of Section 213(b)(6), Congress likely intended to codify the IRS's stated approach, which was in turn based on the Attorney General's opinion. After the enactment of Section 213(b)(6), the IRS noted that "so far as personal injuries are concerned, [Section 213(b)(6)] is merely declarative of the [Attorney General's and IRS's] conclusions and intended to go no further." 2 C.B. 71, 72 (1920) (citing 31 Op. Atty. Gen. 304 and T.D. 2747). The IRS continued: "These conclusions rest, as stated, upon the theory of conversion of capital assets. It would follow that personal injury not resulting in the destruction or diminution in the value of a capital asset would not be within the exemption." *Id.* at 72.

In view of the focus on the "conversion of capital assets" theory in the passage of Section 104(a)(2)'s predecessor, it would be inconsistent with the legislative history to treat punitive damages as excludable from income, since punitive damages in no way resemble a return of capital.

This Court reviewed much of this same legislative and administrative history in *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955). In that case, the Court concluded that punitive damages for fraud and statutory treble damages under the antitrust laws are income subject to tax. In so holding, the Court stated (*id.* at 432 n.8; emphasis added):

> The long history of departmental rulings holding personal injury recoveries nontaxable on the theory that they roughly correspond to a return of capital cannot support exemption of punitive damages[.] * * * *Damages for personal injury are by definition compensatory only.*

As the Court thus indicated in *Glenshaw Glass*, the limitation of Section 104(a)(2) to damages that compensate for the injury—and its inapplicability to awards that punish and deter others—comports with the history and purpose of the statute, as well as with its text and structure. See *Wesson* v. *United States*, 48 F.3d at 898-899; *Hawkins* v. *United States*, 30 F.3d at 1080-1084; *Commissioner* v. *Miller*, 914 F.2d at 590. See also 1 Boris Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 13.1.4, at 13-9 (2d ed. 1989) ("The rationale for [Section 104(a)(2)] * * * is presumably that the recovery does not generate a gain or profit but only makes the taxpayer whole by compensating for a loss.").[5]

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[5] In *Starrels* v. *Commissioner*, 304 F.2d 574, 576 (9th Cir. 1962), the court explained that the history and administration of this statute reveal that "[d]amages paid for personal injuries are excluded from gross income because they make the taxpayer whole from a previous loss of personal rights—because, in effect, they restore a loss of capital." Petitioners

c. The title and structure of the statute reflect the same conclusion.[6] Section 104(a) provides exclusions from income for "[c]ompensation for injuries or sickness," not for sanctions awarded to punish and deter malicious or willful misconduct. 26 U.S.C.

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object (95-966 Pet. Br. at 21-22) to the rhetorical phrase—"in effect, restor[ing] a loss of capital"—that Judge Browning used in describing the objective of the statute. But that phrase followed Judge Browning's more concrete description of the statute's purpose as allowing an exemption for damage recoveries that compensate or "make the taxpayer whole from a previous loss of personal rights." 304 F.2d at 576. An award of punitive damages is not compensation to the plaintiff; it is punishment of the defendant. It therefore does not come within the text or the object of Section 104(a)(2).

[6] Petitioners err in asserting (95-966 Pet. Br. 25) that, under Section 7806(b) of the Internal Revenue Code, the title of a Section may not be considered as an aid in understanding its intended scope. Section 7806(b) provides (26 U.S.C. 7806(b)):

> No inference, implication, or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any particular section or provision or portion of this title, nor shall any table of contents, table of cross references, or similar outline, analysis or descriptive matter relating to the contents of this title be given any legal effect.

Nothing in the plain text of Section 7806(b) bars consideration of the title of a statute in determining its meaning. In *INS* v. *National Center for Immigrants' Rights, Inc.*, 502 U.S. 183 (1991), this Court noted that "the title of a statute or section can aid in resolving an ambiguity in the legislation's text." *Id.* at 189, citing, *e.g.*, *Mead Corp.* v. *Tilley*, 490 U.S. 714, 723 (1989). That same conclusion has been reached by this Court in cases arising under the internal revenue laws. *Maguire* v. *Commissioner*, 313 U.S. 1, 9 (1941) ("the title of an act * * * may be of aid in resolving an ambiguity"). Section 7806(b) of the Code does not require any different conclusion.

104(a).[7] Each of the several subsections of the statute is designed to exempt compensation for a personal injury to the the taxpayer, not recoveries awarded to punish others. Section 104(a)(1) excludes from gross income "amounts received under workmen's compensation acts as compensation for personal injuries or sickness"; Section 104(a)(3) excludes certain "amounts received through accident or health insurance for personal injuries or sickness"; Section 104(a)(4) excludes "amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service"; and Section 104(a)(5) excludes "amounts received by an individual as disability income attributable to injuries incurred as a direct result of a * * * terrorist attack * * * while such individual was an employee of the United States engaged in the performance of his official duties outside the United States." 26 U.S.C. 104(a)(1)-(5). As the Federal Circuit correctly observ-

[7] Petitioners correctly note (95-966 Pet. Br. 16-18) that the title of Section 104—"Compensation for injuries or sickness"—was not contained in the original enactment of the statute as Section 213(b)(6) of the Revenue Act of 1918. But Congress has given that same title to the statute from the first codification in 1939 to the present date. The title was unchanged when the Code was recodified in 1954 and again in 1986. This case relates to taxes owed for 1988, a time subsequent to three codifications in which Congress employed the same title in reenacting Section 104(a)(2). The title that Congress has employed for Section 104 throughout its reenactment of that Section and its recodification over a period of half a century properly serves as an aid in resolving any ambiguity in the text of the statute, certainly as applied to events that occurred subsequent to those reenactments and recodifications.

ed in *Reese* v. *United States*, 24 F.3d at 231, the focus of the statute in general, and of each of its subsections in particular, is on amounts that compensate for injury or sickness, not on payments exacted to punish misconduct. Accord *Hawkins* v. *United States*, 30 F.3d at 1083. Cf. *United States* v. *Burke*, 504 U.S. at 244 (Scalia, J., concurring).

3. a. Petitioners contend (95-966 Pet. Br. 13; see 95-977 Pet. Br. 27-29) that Section 104(a)(2) "clearly and on its face" excludes punitive damages from gross income. Petitioners emphasize that the statute excludes from gross income "*any* damages received * * * on account of personal injuries or sickness" (26 U.S.C. 104(a)(2) (emphasis added)), and they contend that, under this text, the only test for excludability under Section 104(a)(2) is whether the damages at issue were awarded in a personal injury suit.

The flaw in petitioners' position is manifest. Their argument seeks to isolate the statutory term "any damages" from the subsequent term "on account of personal injuries." This Court has emphasized, however, that it does not "construe statutory phrases in isolation; we read statutes as a whole." *United States* v. *Morton*, 467 U.S. 822, 828 (1984). See also *Stafford* v. *Briggs*, 444 U.S. 527, 535 (1980); *Philbrook* v. *Glodgett*, 421 U.S. 707, 713 (1975). Read as a whole, any damages may be excluded under Section 104(a)(2) only if those damages are awarded "on account of personal injuries or sickness." *Commissioner* v. *Schleier*, 115 S. Ct. at 2167.

This Court has expressly rejected the contention that Section 104(a)(2) excludes any award of damages from gross income simply upon proof that the damages were received in a case involving personal injury. See note 3, *supra*. In *Commissioner* v. *Sch-*

leier, the Court stated that whether "the underlying action is 'based upon tort or tort type rights'" is *not* "the beginning and end of the analysis." 115 S. Ct. at 2167. There are "two independent requirements that a taxpayer must meet before a recovery may be excluded under § 104(a)(2)." 115 S. Ct. at 2167. The taxpayer must demonstrate not only that the underlying cause of action is based upon tort or tort type rights; the taxpayer must also demonstrate "that the damages were received 'on account of personal injuries or sickness.'" *Ibid.* Damages that are "punitive in nature" do not satisfy the latter requirement (*id.* at 2165), for they are awarded on account of the "defendant's egregious conduct and the jury's desire to punish and deter such conduct" and "not because of a personal injury" (*Reese* v. *United States*, 24 F.3d at 231).

b. Petitioners contend (95-966 Pet. Br. 14) that the dictionary definition of "on account of" supports their proposed interpretation of the statute. Petitioners note that the term "on account of" is defined to mean "for the sake of," "by reason of," or "because of." *Webster's Third New International Dictionary* (*Unabridged*) 13 (1976). But punitive damages are not received "for the sake of," "by reason of," or "because of" the personal injury suffered. Instead, punitive damages are received "for the sake of," "by reason of," and "because of" the egregious conduct of the defendant and the desire to punish and deter that conduct. Punitive damages are awarded "to vindicate the State's legitimate interest in punishment and deterrence" and may be awarded even in suits that do not involve personal injuries. See *BMW of North America, Inc.* v. *Gore*, No. 94-896 (May 20, 1996), slip op. 7. See also pages 13-15, *supra*.

In addition to the decision of this Court in *Schleier*, five of the courts of appeals have rejected the contention that damages awarded in a personal injury case are excluded from income under Section 104(a)(2) without a showing that the award was "on account of" the injury. See *Wesson* v. *United States*, 48 F.3d at 898; *Hawkins* v. *United States*, 30 F.3d at 1080; *Reese* v. *United States*, 24 F.3d at 230; *Commissioner* v. *Miller*, 914 F.2d at 589-590. See also note 3, *supra*. Petitioners correctly note (95-966 Pet. Br. 30-31) that the Tax Court formerly disagreed with these decisions and once held that an award of punitive damages is excluded from income whenever the underlying claim involves a personal injury. Relying upon this Court's decision in *Schleier*, however, the Tax Court repudiated its former position and now holds that punitive damages are *not* exempt from tax under Section 104(a)(2). The court explained in *Bagley* v. *Commissioner*, 105 T.C. 396, 417 (1995), appeal pending, No. 96-1768 (8th Cir.), that "[t]he Supreme Court has made it clear in the *Schleier* case that damages which are not compensatory but punitive in nature are not excludable from gross income under section 104(a)(2)."

c. Petitioners correctly note (95-966 Pet. Br. 27-31; 95-977 Pet. Br. 31-32) that the Internal Revenue Service has, over time, expressed differing views concerning the excludability of punitive damages under Section 104(a)(2). See Rev. Rul. 85-98, 1985-2 C.B. 51; Rev. Rul. 84-108, 1984-2 C.B. 32; Rev. Rul. 75-45, 1975-1 C.B. 47. During the period prior to 1975 and consistently since 1984, however, the Service has concluded that punitive damages do not represent an award "on account of personal injuries" within the scope of the statute.

It is well settled that "the Commissioner may change an earlier interpretation of the law" (*Dickman* v. *Commissioner*, 465 U.S. 330, 343 (1984)) and thereby "correct mistakes of law in the application of the tax laws to particular transactions" (*Dixon* v. *United States*, 381 U.S. 68, 72 (1965)). Courts are to look to the current, formal view of the Commissioner rather than to a discarded, prior ruling. See *Commissioner* v. *Miller*, 914 F.2d at 591; Mary Jane Morrison, *Getting a Rule Right and Writing a Wrong Rule: The IRS Demands a Return on All Punitive Damages*, 17 Conn. L. Rev. 39 (1984). "[A] revised interpretation deserves deference" if it reflects a "reasoned analysis." *Rust* v. *Sullivan*, 500 U.S. 173, 186-187 (1991), citing, *e.g.*, *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 862 (1984). See also *Smiley* v. *Citibank (South Dakota), N.A.*, No. 95-860 (June 3, 1996), slip op. 6. As the numerous, consistent appellate decisions reflect, the Commissioner's 1984 determination that punitive damages are not excluded from income under Section 104(a)(2) reflects a "reasoned analysis" of the statute and the Treasury's implementing regulation and is therefore entitled to deference.[8]

[8] Deference is afforded to the Commissioner's interpretation of the internal revenue laws because (*National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 477 (1979)):

> "Congress has delegated to the * * * Commissioner, not to the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code. 26 U.S.C. §7805(a)." *United States* v. *Correll*, 389 U.S. 299, 307 (1967). That delegation helps ensure that in "this area of limitless factual variations," *ibid.*, like cases will be treated alike. It also helps guarantee that the rules will be written by "masters of the subject," *United States*

d. Petitioners argue (95-966 Pet. Br. 15-19; 95-977 Pet. Br. 26-29) that the text of Section 213(b)(6) of the Revenue Act of 1918—the original predecessor of Section 104(a)(2)—reflects that, while Congress intended to allow exclusion of only compensatory recoveries for insurance and workmen's compensation claims, it intended to allow a broader exclusion for recoveries for the same types of personal injuries that result from litigation. Section 213(b)(6) provided that gross income did not include (Revenue Act of 1918, ch. 18, § 213(b)(6), 40 Stat. 1066 (1919)):

> Amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries.

Petitioners assert that, while the exclusion for recoveries from accident and health insurance and workmen's compensation were limited to "compensation for personal injuries or sickness," the exclusion for recoveries from "suit or agreement" extended to "any damages received."

Here, as before, the flaw in petitioners' contention is manifest. Petitioners seek to tear asunder words that the statute has joined together. Under the plain text of Section 213(b)(6) of the Revenue Act of 1918, the exclusion for recoveries from a "suit or agreement" involving "personal injuries or sickness" extended only to "any damages received * * * on account of such injuries." The language of that statute is thus indistinguishable from the language of

> v. *Moore*, 95 U.S. 760, 763 (1868), who will be responsible for putting the rules into effect.

Section 104(a)(2), which petitioners have similarly attempted to splinter. See pages 23-24, *supra*.

Petitioners' assertion that a broader exclusion was provided for recoveries through litigation than for recoveries through insurance or workmen's compensation is thus plainly inconsistent with the text of the statute. It also draws no support from common sense. There is no reason to suspect that Congress desired to achieve the implausible result of providing a broader tax immunity for litigation, than for insurance, recoveries for the same "personal injuries or sickness." To the contrary, the history of the statute reflects that it sought to achieve a parity of treatment in the two situations and was drafted to ensure that both would be encompassed within the same exclusionary principle. See *Reese* v. *United States*, 24 F.3d at 232-233; T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918) (noting that the exclusion of insurance and litigation recoveries is based "upon similar principles").

e. Finally, petitioners contend (95-966 Pet. Br. 31-34; Pet. 95-977 Pet. Br. 39-43) that an amendment made to Section 104(a)(2) in 1989 provides evidence that punitive damages are excluded from tax under that statute. In 1989, Section 104(a) was amended to provide that Section 104(a)(2)'s exclusion "shall not apply to any punitive damages [received] in connection with a case not involving physical injury or physical sickness." 26 U.S.C. 104(a). See Revenue Reconciliation Act of 1989, Pub. L. No. 101-239, Tit. VII, § 7641(a), 103 Stat. 2379. In *United States* v. *Burke*, the Court suggested that this amendment "allow[s]" the exclusion of punitive damages in physical injury cases after 1989. 504 U.S. at 236 n.6. That question, however, was not presented in *Burke* and

had not been addressed by the parties in that case. The Court's statements on that issue in *Burke* were therefore dicta. See, *e.g.*, *Reese* v. *United States*, 24 F.3d at 235. The proper interpretation of the 1989 amendment is also not at issue in the present case, which involves events that preceded the effective date of that amendment.

This Court has long rejected the argument that an amendment to the tax laws provides evidence that the law was formerly otherwise. *Higgins* v. *Smith*, 308 U.S. 473, 479-480 (1940). That principle applies with particular force in this case, for neither the text of the 1989 amendment nor its history contains any suggestion that Congress (either in 1989 or in 1919) believed that punitive damages were properly excluded from income under the original statute.[9] Instead, the legislative history of the amendment unequivocally reveals that the purpose of the amendment was quite limited: Congress desired to reverse then-recent decisions that had allowed the exclusion of punitive damages in nonphysical injury cases and, at the same time, to take no position on whether the statute permitted exclusion of punitive damages in physical injury cases.

The 1989 amendment originated in a House bill that would have confined the Section 104(a)(2) exclusion to damages received in cases involving physical injury or physical sickness. H.R. 3299, 101st Cong., 1st

[9] As this Court has frequently emphasized, "the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one." *United States* v. *Price*, 361 U.S. 304, 313 (1960). The interpretive value of an amendment to a statute is particularly dubious when, as here, the amendment was enacted long after the original provision. *Rainwater* v. *United States*, 356 U.S. 590, 593 (1958).

Sess. § 11641 (1989). The House report states that this bill was a reaction to (i) then-recent decisions (prior to *Burke*), such as *Threlkeld* v. *Commissioner*, 848 F.2d 81 (6th Cir. 1988), that had held damages recovered in nonphysical injury cases involving employment discrimination and injury to reputation to be excluded from gross income and (ii) the Tax Court's decision in *Miller* v. *Commissioner*, 93 T.C. 330 (1989), rev'd, 914 F.2d 586 (4th Cir. 1990), which held, prior to its reversal, that punitive damages in a defamation suit were excludable from gross income. H.R. Rep. No. 247, 101st Cong., 1st Sess. 1354-1355 (1989). The House bill was modified in conference to provide only that the Section 104(a)(2) exclusion "shall *not* apply to any punitive damages [received] in connection with a case *not* involving physical injury or physical sickness." Revenue Reconciliation Act of 1989, Pub. L. No. 101-239, Tit. VII, § 7641(a), 103 Stat. 2379 (emphasis added). As Professor Kahn has recently noted, the Conference Committee redacted language from another version of the bill that had affirmatively provided for the exclusion of punitive damages received in physical injury cases and substituted the double negative phraseology contained in the 1989 amendment. Douglas A. Kahn, *Compensatory and Punitive Damages for a Personal Injury: To Tax or Not to Tax?*, 2 Fla. Tax Rev. 327, 369-370 (1995). The amendment enacted by Congress thus precludes application of the Section 104(a)(2) exclusion to punitive damages received in nonphysical injury cases but is silent as to the taxation of punitive damages received in physical injury cases. As Professor Kahn observes (2 Fla. Tax Rev. at 370):

> Congress did not inadvertently omit to make an explicit statment that punitive damages connected with a physical injury are excluded. To the contrary, the draft containing that statement was altered to avoid taking a position on that issue. It is clear then that the 1989 amendment has no bearing on the excludability of punitive damages in cases involving physical injury.

As the Ninth Circuit stated in *Hawkins* v. *United States*, 30 F.3d at 1082:

> Congress may amend a statute simply to clarify existing law, to correct a misinterpretation, or to overrule wrongly decided cases. Thus, an amendment to a statute does not necessarily indicate that the unamended statute meant the opposite. * * * At the time of the proposed amendment, several cases had recently held that § 104(a)(2) excludes damages recovered in cases involving employment discrimination and injury to reputation * * * and some had even held that punitive damages awarded in such cases are excludable. * * * That Congress elected to overrule such cases does not prove that, prior to Congress's action, the statute meant the opposite.

Accord, *Wesson* v. *United States*, 48 F.3d at 901. Nothing in the history of the amending statute indicates an intent to exempt punitive damages in physical injury cases. Any interpretation of the amendment to allow the exclusion of punitive damages in physical injury cases after 1989 would thus be contrary to the fundamental principle of statutory construction that "[e]xemptions from taxation do not rest upon implication." *United States Trust Co.* v.

Helvering, 307 U.S. 57, 60 (1939). Accord, *Hawkins* v. *United States*, 30 F.3d at 1082 n.7.

4. The text, history, purpose, title and structure of Section 104(a)(2) therefore all support the conclusion that punitive damages are not excludable from gross income under that statute. Because Section 104(a)(2) provides an exemption from tax, any ambiguity that might exist in the statute must be resolved in favor of the same conclusion. See *Commissioner* v. *Schleier*, 115 S. Ct. at 2163.

II

A. *The notice of appeal filed by the government in No. 95-977 was timely*

When the United States is a party to a civil case, "the notice of appeal may be filed by any party within 60 days" after the date of entry of the judgment or order. Fed. R. App. P. 4(a)(1); see 28 U.S.C. 2107(b). The United States filed its notice of appeal in this case on February 1, 1994—less than 60 days after the district court entered its final, "amended" judgment of December 7, 1993. Petitioner Kelly O'Gilvie, however, contends (95-977 Pet. Br. 43-46) that the time for filing the appeal ran from the entry of the November 30 judgment that disposed only of the interest issue. He asserts that the government's notice of appeal is therefore untimely. That contention is incorrect.

The courts of appeals have jurisdiction over "appeals from all final decisions of the district courts" (28 U.S.C. 1291). An order is not "final" for purposes of appellate review unless it "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 467 (1978), quoting *Catlin* v. *United States*, 324 U.S. 229, 233 (1945).

When, as in the present case, more than one claim for relief is presented in the district court, an order disposing of only one of the claims is not a "final" order from which an appeal may be taken. Rule 54(b) of the Federal Rules of Civil Procedure provides that (emphasis added):

> [w]hen more than one claim for relief is presented in an action, * * * the court may direct the entry of a final judgment as to one or more but fewer than all of the claims * * * only upon an express determination that there is no just reason for delay and upon an express direction for the entry of judgment. *In the absence of such determination and direction, any order or other form of decision, however designated, which adjudicates fewer than all the claims or the rights and liabilities of fewer than all of the parties shall not terminate the action as to any of the claims or parties*, and the order or other form of decision is subject to revision at any time before the entry of judgment adjudicating all the claims and the rights and liabilities of all the parties.

In this case, petitioner Kelly O'Gilvie asserted two substantive claims for relief: he sought a refund of the taxes he paid (i) on the punitive damage award that he received and (ii) on a portion of the post-judgment interest that he received on that award (Pet. App. 5a-7a). The district court initially adjudicated the punitive damage issue in the government's favor on May 26, 1992. On August 26, 1992, however, the court vacated that order and entered a new order ruling in petitioner's favor on that issue. Then, on October 27, 1992, recognizing that petitioner's refund claim for the taxes paid on post-

judgment interest had not been adjudicated, the court withdrew its August 26 order "subject to reinstatement at the conclusion of the case" (*id.* at 6a n.5). On November 30, 1993, the court addressed the interest issue for the first time, entering judgment in favor of the government (*id.* at 5a-6a). One week later, on December 7, 1993, the court entered an "amended" and final order that (i) granted judgment in favor of petitioner on his claim that the punitive damage award was not subject to tax and (ii) granted judgment in favor of the United States on petitioner's claim that the interest he received was not subject to tax (*id.* at 6a). The government filed its notice of appeal within 60 days of the last order entered by the district court (*id.* at 7a).[10]

Only the judgment of December 7 adjudicated *all* of the claims of the parties in this suit. None of the prior orders—including the order of November 30, 1993—disposed of all of the issues in the case. None of the prior orders was therefore a final, appealable order. See, *e.g.*, *UGI Corp.* v. *Clark*, 747 F.2d 893 (3d Cir. 1984); *International Controls Corp.* v. *Vesco*, 535 F.2d 742, 748 (2d Cir. 1976); 6 James Wm. Moore, *Moore's Federal Practice* ¶ 54.34[1], at 54-169 to 54-170 (1996). As the court of appeals correctly held (Pet. App. 7a-8a), because the notice of appeal was filed by the United States within 60 days of the final judgment entered on December 7, 1993, the appeal was timely.[11]

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[10] The United States also appealed the separate order in the companion case that involved the refund made to Kevin and Stephanie O'Gilvie (Pet. App. 7a n.6). The timeliness of the appeal filed in that case is not disputed.

[11] This case does not involve a correction of a clerical error under Fed. R. Civ. P. 60(a). Until the December 7 judgment was entered, there had been no final judgment from which an appeal could properly be taken. That the court denominated its final judgment as an "amended" judgment does not alter the fact that none of its prior orders had disposed of the entire case. See Fed. R. Civ. P. 54(b).

B. *The government's suit for recovery of the erroneous refund in No. 95-966 was timely*

Under Section 7405(a) of the Internal Revenue Code, any refund that "is erroneously [made] * * * may be recovered by civil action brought in the name of the United States." 26 U.S.C. 7405(a). Section 6532(b) of the Code provides a statute of limitations for such claims. It specifies that, in the absence of fraud by the taxpayer, "[r]ecovery of an erroneous refund by suit under section 7405 shall be allowed only if such suit is begun within 2 years after the making of such refund" (26 U.S.C. 6532(b)).

The government commenced its suit for recovery of the erroneous refunds against petitioners in No. 95-966 on July 9, 1992. The complaint alleged that the erroneous refund was made on July 9, 1990 (J.A. 62a). Petitioners admitted the truth of that allegation in their answer (J.A. 64a). The answer claimed only that the refunds were not erroneous; no other defense was pled. In particular, neither the answer nor any further pleading alleged that the statute of limitations on the government's claim had expired (J.A. 64a-65a).[12]

When the United States appealed the judgment entered in petitioners' favor on the merits of the tax

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[12] In a stipulation filed by the parties more than one year after the complaint was filed, the parties agreed that "[t]here are no factual issues in dispute" and that "[t]he sole legal issue in dispute between the parties is whether the punitive damages received by [petitioners] are excludable from income pursuant to 26 U.S.C. Section 104(a)(2)" (Pet. App. 39a).

issue in the district court (J.A. 66a), petitioners sought to raise for the first time a new contention in support of the judgment below. They asserted that, although they received the refund checks on July 9, 1992, the "checks had to have been mailed before July 9, 1990" (Pet. App. 8a). They argued that a "refund" is made for purposes of the two-year statute of limitations in Section 6532(b) when the check is mailed, not when it is received, and that the government's suit for recovery of the refund was therefore necessarily untimely (*ibid.*). Petitioners are in error for two separate reasons:

(i) The statute of limitations is an affirmative defense. It must be pled "affirmatively" in the answer. Fed. R. Civ. P. 8(c). The answer filed by petitioners, however, failed to raise the statute of limitations as a defense. The answer also admitted facts that establish that the government's suit (commenced on July 9, 1992) was timely, for it admitted that "[o]n July 9, 1990, the Internal Revenue Service refunded" the amounts at issue in this case (J.A. 62a, 64a). The stipulation thereafter filed by petitioners made the same factual concession and further affirmatively stated that the only "legal issue" presented in this case is the applicability of Section 104(a)(2) to punitive damage awards (Pet. App. 39a). Because the affirmative defense of the statute of limitations was not raised in the pleadings or otherwise presented to the district court, and because that defense is precluded and, indeed, contradicted by the stipulation of the parties, petitioners are barred from raising that issue in the court of appeals and in this Court. See, *e.g.*, *Marcus* v. *Sullivan*, 926 F.2d 604 (7th Cir. 1991); *Roberts* v. *College of the Desert*, 870 F.2d 1411 (9th Cir. 1989); 2A James Wm. Moore, *Moore's Federal Practice* ¶ 8.27[3], at 8-172 (2d ed. 1995) ("Nor may an affirmative defense be raised for the first time on appeal.").

In an effort to justify raising this issue for the first time in the court of appeals, petitioners asserted that a failure to comply with the statute of limitations in Section 6532(b) deprives the district court of subject matter jurisdiction over the government's case (Pet. App. 7a)—a defense that may be raised at any time. But Section 6532(b) does not create a jurisdictional bar to an untimely suit. A statute of limitations "[o]rdinarily" represents an affirmative defense to a cause of action, not a jurisdictional bar to an untimely suit. *Dieckmann* v. *United States*, 550 F.2d 622, 623 (10th Cir. 1976). When a statute is expressly worded to bar an untimely "suit or proceeding" against the United States, it has been held to create a jurisdictional bar to the untimely action. *Ibid.* But a statute such as Section 6532(b)—that bars only the "[r]ecovery" on an untimely suit (26 U.S.C. 6532(b)) —is a limitation on the cause of action, not on the jurisdiction of the court. A defense based on a statute that is a "limitation on the remedy, not on the right to bring the action, * * * must be pled as an affirmative defense in compliance with Fed.R.Civ.P. 8(c)." *Mumbower* v. *Collicot*, 526 F.2d 1183, 1187 n.5 (8th Cir. 1975). A failure to plead the defense constitutes a waiver, and the defense may not thereafter be asserted for the first time on appeal. *Davis* v. *Bryan*, 810 F.2d 42, 44 (2d Cir. 1987); *Hodgson* v. *Humphries*, 454 F.2d 279 (10th Cir. 1972).[13]

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[13] Even if the statute of limitations contained in Section 6532(b) were jurisdictional in nature, petitioners could not prevail on the facts of this case. Petitioners admitted that the

(ii) Under Section 6532(b) of the Internal Revenue Code, recovery of an erroneous refund is allowed if the suit is brought within two years "after the making of such refund" (26 U.S.C. 6532(b)). The court of appeals correctly held (Pet. App. 10a) that the date that the funds are delivered to the taxpayer, rather than the date that the refund check was issued or mailed, is the date a "refund" is made for purposes of Section 6532(b). In explaining that same conclusion in *Paulson* v. *United States*, 78 F.2d at 99, the court stated:

> Refund means to pay back, return, restore, make restitution. That is the ordinary and popular concept of the word, and in the absence of a contrary indication, it must be presumed that the Congress used it in the generally accepted sense. The return, restoration, and restitution of the money is made when the check in payment of the obligation is delivered.

The holding of the court of appeals draws ample support from the decision of this Court in *United States* v. *Wurts*, *supra*. The question in *Wurts* was whether the two-year period for bringing suit for an erroneous refund begins when the refund is administratively allowed or when it is paid. 303 U.S. at 415. The suit in *Wurts* had been brought less than two years after the refund check was mailed but more

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amounts involved in this case were "refunded" by the United States on July 9, 1990 (J.A. 62a, 64a) and the suit was commenced exactly two years later. There is no proper basis for petitioners now to attempt to contradict their stipulation—by raising new factual contentions on appeal—for they stipulated in the district court that there were "no factual issues in dispute in this litigation" (Pet. App. 39a).

than two years after the refund was approved by the Commissioner. Noting that words in statutes are to be given their common meaning, the Court explained that the common meaning of "refund" is "to return (money) in restitution, repayment." *Id.* at 417. The Court noted that administrative allowance of a refund "does not finally establish a claimant's right to a refund and does not preclude further investigation and consideration of the claim." *Ibid.* In particular, a refund may be cancelled "even after a check was signed and mailed." *Id.* at 417-418. The Court therefore held that the statute of limitations runs from the date of payment and not from the date on which the refund is administratively allowed.

Petitioners assert (95-966 Pet. Br. 37) that, when this Court stated in *Wurts* that the limitations period "begins to run from the date of payment" (303 U.S. at 418), it meant from the date of mailing. That contention is plainly incorrect. Nothing in the Court's opinion in *Wurts* supports the notion that the Court equated the date of payment with the date of mailing. To the contrary, the Court stated that a refund is not made, because it may be cancelled, "even after a check is signed and mailed." 303 U.S. at 417-418.

Noting that a refund is not actually made until the funds are delivered to the taxpayer, other courts have consistently applied the analysis of *Wurts* to reach the same conclusion reached by the court of appeals in this case. For example, in *United States* v. *Carter*, 906 F.2d 1375 (1990), the Ninth Circuit rejected the argument presented by petitioners in this case, holding that "[t]he refund is considered to have been made on the date the taxpayer received the refund check." *Id.* at 1377. Numerous other decisions are in accord. See, *e.g.*, *United States* v. *Woodmansee*, 388 F. Supp.

36, 46 (N.D. Cal. 1975), rev'd on other grounds, 578 F.2d 1302 (9th Cir. 1978); *Akers* v. *United States*, 541 F. Supp. 65, 67 (M.D. Tenn. 1981) ("[t]he operative date in relation to the statute of limitations [of Section 6532(b)] is not the date of the check's issuance, but the date on which the check was received by the taxpayer"); *United States* v. *Bruce*, 642 F. Supp. 120, 122 (S.D. Tex. 1986) (same). Professional commentary has also reached the same conclusion. See, *e.g.*, 14 *Mertens Law of Federal Income Taxation* § 54A.69 (Lisa Fagan, *et al.* eds., 1996) (erroneous refund suit must be brought "within two years of the date of delivery of the refund check"); Michael Saltzman, *IRS Practice and Procedure* ¶ 14.08[2][g], at 14-60 (2d ed. 1991); Rita A. Cavanagh & Gerald A. Kafka, *Litigation of Federal Tax Controversies* § 20.03, at 20-9 (1994).

This Court has frequently stated that statutes of limitations on the claims of the United States must be strictly construed in favor of the government. See, *e.g.*, *Badaracco* v. *Commissioner*, 464 U.S. 386, 391 (1984); *Dupont DeNemours & Co.* v. *Davis*, 264 U.S. 456, 462 (1924). Indeed, in interpreting the predecessor of Section 6532(b), the Court emphasized that "[t]he Government's right to recover funds, from a person who received them by mistake and without right, is not barred unless Congress has 'clearly manifested its intention' to raise a statutory barrier." *United States* v. *Wurts*, 303 U.S. at 416, quoting *United States* v. *Nashville, C. & St. L. Ry.*, 118 U.S. 120, 125 (1886). Section 6532(b) contains no clear manifestation of intent for a "mailing" to be regarded as a "refund."

Ignoring that the text of the statute must be strictly construed, petitioners assert (Br. 36, 38-41) that treating a "mailing" as if it were a "refund" would be supported by common sense and by "practical" considerations. In fact, however, common sense and practicality point the other way. If, as petitioners assert, a "refund" is made simply by the act of placing a check in the mail, the Commissioner arguably could recover an erroneous "refund" even if the check were lost and never actually received by the taxpayer. The Commissioner could also refuse to issue a replacement refund check even if it were established that, after mailing, the original refund check was destroyed through no fault of the taxpayer. Neither of these results would comport with common sense.

Under the consistent view of the courts and commentators, and under this Court's decision in *Wurts*, a "refund" is not made for purposes of Section 6532(b) until the funds are delivered to the taxpayer. Under that straightforward application of the plain text of the statute, the government's suit for recovery of the refund was timely in this case.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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